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In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 637

UNITED STATES OF AMERICA, PETITIONER

v.

JOHN B. ATKINS

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of the United States, files this petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in this case.

OPINIONS BELOW

The opinion of the District Court (R. 163-182) is reported at 86 F. Supp. 342. The original opinion of the Court of Appeals (R. 207-211) is reported at 189 F. 2d 414. The first opinion of the Court of Appeals on rehearing (R. 226-227) is reported at 191 F. 2d 146, and its second opinion on rehearing, together with the dissenting opinion (R. 235-238), is reported at 191 F. 2d 951.

JURISDICTION

The original judgment of the Court of Appeals in favor of the United States was entered on May 1, 1951. (R. 211.) The order of the Court of Appeals setting aside this judgment on the petition of the taxpayer for rehearing and giving judgment for the taxpayer was entered August 31, 1951. (R. 227-228.) The order denying the petition of the United States for rehearing was entered on October 30, 1951. (R. 238.) The time for filing a petition for a writ of certiorari was extended to and including March 8, 1952, by order of Mr. Justice Black, dated January 22, 1952. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether, under Sections 181 and 182 of the Internal Revenue Code, and this Court's decision in *Burnet* v. *Leininger*, 285 U. S. 136, a partner may divide his partnership income for tax purposes with one who is not a partner.[1]

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[1] In the courts below it was also contended by the United States that the sub-partnership between the taxpayer and his son, through which the taxpayer sought to divide his partnership income, was not, for tax purposes, to be recognized as a valid business partnership under the tests most recently stated by this Court in *Commissioner* v. *Culbertson*, 337 U.S. 733. Both lower courts decided this question adversely to the United States. (R. 179-182, 226-227.) In the event this petition for certiorari is granted, the right is reserved by the Government to argue as an alternative point that the father-son sub-partnership is not to be recognized for tax purposes.

STATUTE INVOLVED

Internal Revenue Code:

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U.S.C. 1946 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) [As amended by Section 150 (g), Revenue Act of 1942, c. 619, 56 Stat. 798] As part of his gains and losses from sales or exchanges of capital assets held for not more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for not more than 6 months.

(b) [As amended by Section 150 (g), Revenue Act of 1942, *supra*] As part of his gains and losses from sales or exchanges of capital assets held for more than 6 months, his distributive share of the gains and losses of the partnership from sales or exchanges of capital assets held for more than 6 months.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

(26 U.S.C. 1946 ed., Sec. 182.)

STATEMENT

During the taxable year 1943, the taxpayer was a partner with another partner or partners in three business partnerships. These were Highland Oil Company, engaged in the business of marketing petroleum products, in which the taxpayer and one R. R. Brinkmann each had a 50 percent interest; Triangle Refineries, Ltd., also engaged in the business of marketing petroleum products, in which one J. B. Saunders had a 50 percent interest and the taxpayer and Brinkmann each had a 25 percent interest; and Petroleum Dehydrating Company, engaged in the business of treating the oil-water emulsions accumulated in the bottoms of oil storage tanks, in which the taxpayer had a 60 percent interest and one B. S. DeMering originally had a 40 percent interest.[2] Each of the businesses was managed and operated by the other partners, or one of them. The taxpayer furnished the capital which was required initially and from time to time in carrying on these businesses, but he did not participate in managing them, except to decide whether or not he would provide capital for the purpose outlined by the managing partner. (R. 92-93, 101, 113, 167-169.)

On July 1, 1943, the taxpayer and his son John, who was then 18 years old, entered into a partner-

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[2] By 1943, as taxpayer testified (R. 73), DeMering's interest had been reduced to 25 percent, although taxpayer still had a 60 percent interest. Brinkmann then (1943) had a 10 percent interest and one Worley a 5 percent interest. In 1947, their agreement was reduced to writing. (R. 155-162.)

ship agreement forming Atco Investment Company, in which the taxpayer had a 75 percent interest and the son a 25 percent interest. The agreement provided that the taxpayer was to contribute as capital his "equity" in the three business partnerships at the value appearing on the books of each company as of July 1, 1943, and that the son would contribute 25 shares of stock of Hanlon Gasoline Corporation at its July 1 market value, and sufficient cash to make the value of his contribution equal one-third the value of taxpayer's contribution. (R. 170, 171.)

Pursuant to this agreement, the taxpayer contributed his equities in the three business partnerships at an aggregate value of $124,276.07. The son John contributed United States Series E bonds of a value on maturity of $3,000, the 25 shares of Hanlon stock, which had been received by gift from the taxpayer in 1940, at a value of $16,666.67, and $21,758.68 in cash, making his contribution aggregate $41,425.35. The son borrowed $20,000 of the cash which he contributed from the taxpayer, and repaid this amount later from the distributions of profits made to him by the partnership. (R. 125-126, 169, 170, 174-175.)

The partnership agreement provided, *inter alia*, that either partner had the right to request and require a termination or liquidation of the partnership by giving the other partner 30 days written notice, and that upon such termination each part-

ner was to receive back, in kind, the assets contributed by him, so far as possible, the purpose being to restore to him that which was contributed by him. (R. 171, 173-174.)

Before forming Atco, the taxpayer advised each of his operating partners in the three business partnerships that he intended to contribute his interest in those businesses to a partnership composed of himself and his son. These partners consented to this but did not agree to become partners with Atco or the son.[3] They requested that taxpayer's name be left on their books as owning the interests, in order to avoid any explanations to creditors. As found by the Court of Appeals, the taxpayer remained the partner in these partnerships and neither Atco nor his son became a partner. (R. 175, 210-211, 235.)

[3] Saunders and Brinkmann testified in this suit (R. 95-96, 102, 106) that taxpayer was, and continued after the formation of Atco to be, their partner in the operating partnerships. Nor did taxpayer testify that Atco was substituted as partner in his place in any of the partnerships. (See R. 56.) The checks issued by Highland and Triangle were made payable to taxpayer, rather than to Atco. (R. 71, 97, 103.) The 1943 partnership returns of Highland and Triangle, signed and sworn to respectively by Brinkmann and Saunders, listed taxpayer, not Atco, as the partner entitled to receive the distributive share of the profits. (R. 95-96, 102, 103-105.)

With respect to Petroleum Dehydrating Company, the taxpayer originally, in 1940, employed DeMering on a profit sharing basis. (R. 144-145.) By 1943, there was a partnership consisting of taxpayer, DeMering, Brinkmann, and one Worley, apparently operating under an oral agreement. (R. 73, 75.) In 1947, these four partners reduced their agreement to writing. (R. 76, 155-162.) There is no testimony that DeMering, Brinkmann, or Worley agreed to accept Atco or the son as their partner in place of taxpayer in 1943, and the 1947 agreement, significantly, is made with taxpayer, not Atco or the son.

The Atco partnership agreement provided that taxpayer would continue to represent the partnership as the Atco administrating partner in the three business partnerships and that all funds received by him from them would be endorsed by him over to Atco. It also provided that the stock and bonds contributed by the son would be held in his name and that all funds received by him from them would be paid over to Atco. (R. 172.) The agreement did not provide expressly that Atco, the subpartnership, was obligated to bear the taxpayer's share of the losses of the business partnerships (R. 170-174), but only that the losses of Atco, if any, were to be borne by taxpayer and his son according to their interests (R. 172).

On October 6, 1943, the taxpayer entered into a partnership agreement with one L. J. Franklin, each having a 50 percent interest therein, to conduct a soft drink bottling and distribution business under the name of 7-Up Bottling Company, Carthage, Texas. (R. 152-155.) The taxpayer was to contribute capital and Franklin was to contribute his bottling and distribution franchise and was to manage and operate the business. Franklin was given two checks aggregating $15,000, drawn on the account of Atco.[4] Neither Atco

[4] It was stipulated (R. 71) that on August 12, 1943, taxpayer received a $10,000 check and on September 22, 1943, he received another $10,000 check from Highland Oil Company, which he deposited in Atco's account. Evidently, the $15,000 contributed to the 7-Up partnership came from these receipts of the taxpayer.

nor the son was a partner in the 7-Up enterprise. Its tax return showed only Franklin and the taxpayer as partners. (R. 176-177, 210; Ex. D-4, transmitted to the lower court in original form (R. 202).)

For the year 1943, the taxpayer reported his income and victory tax liability on the theory that one-quarter of the Atco income was not his, but his son's. The Commissioner rejected this view and asserted a deficiency; the taxpayer paid the deficiency assessment and filed a claim for refund (R. 1-9, 209). Failure of the Commissioner to act on this claim led to this suit for refund in the District Court (R. 1, 4).

The District Court concluded that Atco was a valid partnership to be recognized for tax purposes and that the part of its income which was distributed or was distributable to the son in 1943 is not taxable to the taxpayer. There is no stated conclusion that the taxpayer's distributive share of the profits of the four business partnerships constituted income of Atco on which he is taxable only to the extent of 75 percent, although that apparently was the conclusion of the District Court. (R. 179-182.)

In its original opinion, the Court of Appeals held that, since the taxpayer was the partner in the four business partnerships in 1943, he is taxable on his distributive shares of their incomes, notwithstanding his assignment of his interests and

profits to Atco. Accordingly, it reversed the District Court. (R. 207-211.) On the taxpayer's petition for rehearing and supporting brief (R. 211-225), the Court of Appeals reversed itself and affirmed the District Court on the ground that Atco was a valid partnership for tax purposes (R. 226-227). On the Government's petition for rehearing (R. 228-234), the Court of Appeals, in a third opinion, Judge Russell dissenting, adhered to the conclusion reached in its second opinion affirming the District Court (R. 235-238).

REASONS FOR GRANTING THE WRIT

1. *Burnet* v. *Leininger,* 285 U.S. 136, like *Lucas* v. *Earl,* 281 U.S. 111, is a landmark in the field of federal income tax law. When, as here, a lower federal court has rejected its teaching on grounds which are so broad as to leave no place for that authoritative ruling, review by this Court is indicated.

Section 181 of the Code, *supra,* p. 3, provides that individuals carrying on business in partnership shall be liable for income tax only in their individual capacity, and Section 182, *supra,* p. 3, provides that in computing the net income of each partner he shall include, whether or not distribution is made to him, his distributive share of the ordinary net income or loss and of the capital gains or losses of the partnership. The court below held (R. 210-211) that, after the formation of Atco, the taxpayer, and not Atco or taxpayer's

son, was and continued to be the partner in the business partnerships. This holding was correct (see fn. 3, *supra,* p. 6) and, on rehearing, the court did not disavow it (R. 235). Sections 181 and 182 require, therefore, that taxpayer, as the partner, include in his income his distributive share of the profits of these partnerships.

Burnet v. *Leininger,* 285 U. S. 136, makes it plain that taxpayer can not escape the mandate of these sections by having agreed in advance with his son that his distributive shares of these profits would be paid over to their sub-partnership, where the son or the sub-partnership did not by agreement with the other partners become a partner in the business enterprises. In the *Leininger* case, the taxpayer, by agreement, made his wife a full equal partner with him in his interest in a partnership conducting a laundry business, entitled to share equally in the profits and obligated to bear equally any losses. This agreement was communicated to Leininger's partners in the lanudry business but there was no evidence that they consented that the wife should become their partner in that business, and she contributed neither capital nor services nor management to it. Pointing out that the wife did not become owner of the partnership assets, that her name did not appear on the partnership books as owner of an interest, that no checks for profits were drawn in her favor, and that the partnership returns did not list her as

a partner (p. 140), this Court construed the sub-partnership agreement as no more than an equitable assignment to the wife of one-half of what the husband was entitled to receive from the laundry business, coupled with an agreement by her to make good to him one-half of the losses he might sustain in the business (pp. 140-141). It concluded (p. 141) that even though the wife, by virtue of the agreement, became the beneficial owner of one-half of the profits which her husband should derive from the firm, he, under Section 182, was taxable on his entire distributive share of the income, since he and not the wife was the partner in the business.

There is no basis on which the present case can be distinguished from the *Leininger* case. Here, the majority of the Court of Appeals thought that, after the taxpayer transferred his interests in the operating partnerships to Atco, he was a partner in name only with no beneficial interest (as to the one-fourth share placed in the son) (R. 235-236). But that is irrelevant for, as was made clear in the *Leininger* case (pp. 141, 142-143), in which the wife also acquired the beneficial interest in one-half of her husband's partnership interest, the statute taxes the distributive share of each partner in the income to him by virtue of his being the partner. The beneficial interest of the son here, like that of the wife in *Leininger,* was only a "derivative interest", flowing from his agreement

with his father and not from any right to receive a part of the earnings as a member of the partnerships.

Nor is any distinctive significance to be drawn from the statement in the second opinion of the Court of Appeals (R. 227), that the taxpayer did not merely assign his income from the operating partnerships but assigned his entire interest in those partnerships to a separate partnership. For it was Leininger's interest in the laundry partnership that was the subject of the agreement with his wife, not merely his share of the earnings, as this Court noted (p. 140; see also p. 139, fn. 1). Here, as in *Leininger,* the taxpayer remained the partner in the businesses, his interest remained in his name on the partnership books, the checks for his distributive share of the profits were issued in his name, the son did not acquire ownership of the assets of the partnerships, he did not acquire the right to exercise even the type of limited control which the taxpayer had in the enterprises, he did not contribute any capital to them. Thus, as in that case (pp. 140-141), notwithstanding the asserted transfer of taxpayer's interest in the business partnerships, the sub-partnership agreement amounted only to an equitable assignment of one-fourth of what taxpayer would receive from the operating partnerships. Indeed, the fact that the agreement was in reality merely an assignment of a share of the taxpayer's profits from the operating partnerships is even more clearly apparent in

this case than in *Leininger,* for this taxpayer, although ostensibly contributing his interests in the operating partnerships to the sub-partnership, retained the power to retake them at any time at will upon 30 days notice. (R. 171, 173-174.) Cf. *Corliss* v. *Bowers,* 281 U.S. 376. In any event, even on the assumption that taxpayer assigned his interests in the partnerships, it was not taxpayer's individual interest in the operating partnerships which produced the income in question but the business enterprises themselves. See *Burnet* v. *Leininger,* 285 U.S. 136, 141. Thus, taxpayer's shares of the partnerships' income in 1943 were attributable to his continuing status as a partner, not to the "equity" which he purportedly transferred.

Finally, there is no basis for the view of the lower court (R. 235) that the taxpayer should not be taxed on his distributive shares of the income of the operating partnerships when he and his son will again be taxable on these shares as income of the sub-partnership. A similar contention was made in the *Leininger* case (Supplemental Brief for Respondent, pp. 2-3, No. 426, October Term, 1931) without avail, and the answer to it is simple. No double taxation of this kind could result, because the taxpayer's distributive shares of the profits of the operating partnerships, which, by statutory mandate are his taxable income, would not constitute income of the sub-partnership, assuming for present purposes that it was a partner-

ship recognizable for tax purposes (see fn. 1, *supra*, p. 2). On the contrary, taxpayer's assignment of his profits to Atco in advance of payment represented a contribution or gift from the taxpayer which became effective when the amounts were received by Atco for distribution to its members. See *Helvering* v. *Horst*, 311 U.S. 112, 114, 117, where the assignment of negotiable interest coupons to another in advance of payment was specifically recognized as a gift to the recipient of the interest and was held to be income to the assignor. See also *Harrison* v. *Schaffner*, 312 U.S. 579. Indeed, this Court has frequently approved the taxation of income to the person earning or otherwise creating the right to receive it, even though the "income" is actually received by another (a member of his family) pursuant to agreement and has been returned by him as his taxable income. E.g., *Lucas* v. *Earl*, 281 U.S. 111; *Helvering* v. *Clifford*, 309 U.S. 331; *Commissioner* v. *Tower*, 327 U.S. 280; *Lusthaus* v. *Commissioner*, 327 U.S. 293; *Commissioner* v. *Sunnen*, 333 U.S. 591. Thus, contrary to the lower court's view (R. 235), there would be no failure to accord to the subpartnership, assuming *arguendo* that it is valid, the tax recognition to which it would be entitled, since any items constituting income to it, as distinguished from amounts such as the contributions here which are not income, would be taxable to its partners in accordance with their distributive shares.

2. The judgment of the Court of Appeals conflicts in principle with decisions of other Courts of Appeals, both before and since the *Leininger* case, holding that an assignment or transfer of a partnership interest (whether of income alone or of the entire interest) which does not make the assignee (whether a sub-partnership, a trust, or an individual) a partner, is ineffectual to relieve the assignor of tax on his distributive share, as a partner, of the firm income. See *Mitchel* v. *Bowers*, 15 F. 2d 287 (C.A. 2), certiorari denied, 273 U.S. 759; *Harris* v. *Commissioner*, 39 F. 2d 546 (C.A. 2); *Larsen* v. *Burnet*, 50 F. 2d 308 (C.A. D.C.); *Luce* v. *Burnet*, 55 F. 2d 751 (C.A. D.C.); *Battleson* v. *Commissioner*, 62 F. 2d 125 (C.A. 9); *Rossmoore* v. *Commissioner*, 76 F. 2d 520 (C.A. 2); *Balkwill* v. *Commissioner*, 77 F. 2d 569 (C.A. 6), certiorari denied, 296 U.S. 609; *Rosevear* v. *Commissioner*, 31 B.T.A. 146, affirmed *per curiam, sub nom. Young* v. *Commissioner*, 77 F. 2d 1023 (C.A. 2); *Morton* v. *Thomas*, 158 F. 2d 574 (C.A. 5), certiorari denied, 330 U.S. 834; *Siarto* v. *Commissioner*, 171 F. 2d 293 (C.A. 6), affirming *per curiam* a memorandum opinion of the Tax Court dated January 7, 1947 (1947 P-H T.C. Memorandum Decisions, par. 47,000); *Yiannias* v. *Commissioner*, 180 F. 2d 115, 118-119 (C.A. 8); *Settos* v. *United States*, 192 F. 2d 521 (C.A. 7); cf. *Bourne* v. *Commissioner*, 62 F. 2d 648, 649 (C.A. 4).

The present decision and that of the Seventh Circuit in *Rupple* v. *Kuhl*, 177 F. 2d 823, are the

only ones of which we are aware which dissent from this principle.[5] For the reasons already given in Point 1 with respect to the decision in this case, we believe that the *Rupple* case was also wrongly decided under Code Sections 181 and 182 and *Burnet* v. *Leininger,* 285 U.S. 136. The fact that the wife in the *Rupple* case supplied the capital which was used to finance the acquisition by her husband of a one-third interest in the firm should not have dictated a different result, as the Seventh Circuit thought it did (p. 826), since she did not become a partner and her contribution of capital in legal effect was a loan or donation to her husband of such capital, in return for which she became entitled, under the sub-partnership agreement, to her agreed part of her husband's distributive share of the partnership income. See *Battleson* v. *Commissioner,* 62 F. 2d 125 (C.A. 9), and *Larsen* v. *Burnet,* 50 F. 2d 308 (C.A. D.C.).

3. The issue presented by this case is now of such importance that it should be reviewed by this Court. Prior to the decisions in this case and in *Rupple* v. *Kuhl,* 177 F. 2d 823 (C.A. 7), it appeared to be an accepted principle (see cases cited

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[5] In *Black* v. *Commissioner,* 114 F. 2d 355 (C.A. 9), it was held that a wife as community owner of one-half of the partnership assets with her husband, a partner in a farming partnership, was taxable on one-half of her husband's share of the partnership profits. The fact that the wife was co-owner of the land used by the partnership was thought sufficient to distinguish the case from *Leininger.* The Ninth Circuit has, however, followed the *Leininger* case. *Battleson* v. *Commissioner, supra.*

in Point 2, above) that a partner could not avoid the income tax on his distributive share of partnership income by transferring the right to receive some or all of it to another, if his assignee did not actually become a partner in the enterprise.[6] These two recent decisions raise serious doubt as to whether that principle, as enunciated in the *Leininger* case, will now be followed. If it is to be abandoned or qualified, it is properly the function of this Court, rather than the lower courts, to so declare. In any event, the controlling principles need restatement by this Court, as the three opinions written by the lower court in this case, with the various shifts in views, cogently illustrate.

The question is a frequently recurring one, as the cases referred to in this petition fully demonstrate.[7] The question is presently before the Court of Appeals for the Second Circuit in *Sommers* v. *Commissioner,* in which taxpayer sought to attribute one-half of his distributive share of partner-

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[6] Where the assignee did become a partner under the facts, he has of course been held taxable on his share of the income. *Rose* v. *Commissioner,* 65 F. 2d 616 (C.A. 6); *Armstrong* v. *Commissioner,* 143 F. 2d 700 (C.A. 10). See also the recent decision of the Tax Court in *Wheelock* v. *Commissioner,* 16 T.C. 1435, and cf. *Estate of Blades* v. *Commissioner,* 15 T.C. 190.

[7] The Tax Court also has decided the question on various occasions. Some examples are *Lubets* v. *Commissioner,* 5 T.C. 954; *Richter* v. *Commissioner,* 4 T.C. 271, 278-279; *Granucci* v. *Commissioner,* 47 B.T.A. 662; *Wester* v. *Commissioner,* decided February 28, 1950 (1950 P-H T.C. Memorandum Decisions, par. 50,059); *Tranchina* v. *Commissioner,* decided August 8, 1949 (1949 P-H T.C. Memorandum Decisions, par. 49,181); *Kastel* v. *Commissioner,* decided November 6, 1945 (1945 P-H T.C. Memorandum Decisions, par. 45,333).

ship income to his wife, who was not a partner but who claimed to be in a joint venture with her husband since she had transferred property to her husband which he had then contributed to the partnership. Originally decided on January 8, 1952, on other grounds (1952 P-H, par. 72,246), the *Sommers* case is now pending on petition for rehearing, in connection with which the court has requested from the parties briefs upon the question whether the taxpayer-partner may deduct from his income so much of his distributive share of the partnership earnings as is attributable to the property transferred to him by his wife. It will of course be the Government's general position that no such deduction is allowable since it indirectly would permit the taxpayer to divide his distributive share of partnership earnings with his wife who was not a partner, in contravention of Section 182 and the *Leininger* case; that the wife did not contribute to the partnership the property in question, but that, in contemplation of law, she loaned that property to her husband, who, as the partner, invested it in the partnership.

From the administrative standpoint, it is important that the confusion engendered by the decision in this case be resolved. The decision will foster litigation in cases which otherwise could have been disposed of by the Treasury administratively on the basis of the *Leininger* case. Furthermore, if the decision stands, an effective method is demonstrated for dividing business partnership

income among members of a family by means of a sub-partnership, which could not otherwise be achieved if the business partners are unwilling to accept the family members as partners. Other taxpayers should certainly not be encouraged to use this device by a failure to review this case.

CONCLUSION

For the reasons given, this petition for a writ of certiorari should be granted.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

MARCH, 1952

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